

Letter of Findings: 04-20130527
Gross Retail Tax
For the Years 2009, 2010, and 2011

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUES

I. Gross Retail Tax – Packaging Equipment.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-2; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-5-3; IC § 6-2.5-5-3(b); IC § 6-2.5-4-1; IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10](#).

Taxpayer argues that its purchase of wrapping and packaging equipment is exempt from the state sales/use tax.

II. Gross Retail Tax – Statute of Limitations.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4(b); IC § 6-8.1-5-2(a).

Taxpayer maintains that the assessment of tax on the purchase of items, which occurred in December 2008, is barred by the statute of limitations.

III. Gross Retail Tax – Capital Asset Purchases / Sampling Methodology.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-4-1; IC § 6-8.1-5-1(c); IC § 6-8.1-3-12(b).

Taxpayer states that the Department's audit and sampling methodology was "skewed," "inconsistent," and "unfair."

STATEMENT OF FACTS

An out-of-state business operates an Indiana location which is here designated as "Taxpayer." Taxpayer is a shipping and wholesale company which packages and delivers out-of-state business's products.

The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in an assessment of additional sale/use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Gross Retail Tax – Packaging Equipment.

DISCUSSION

Taxpayer argues that the Department should not have assessed tax on its purchase of wrapping equipment, packaging equipment, and the parts for that equipment.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-1-2; IC § 6-2.5-4-1. A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2.

Taxpayer makes no specific legal argument establishing that its packaging and wrapping equipment is exempt but apparently relies on two regulations which state as follows:

- (a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [\[45 IAC 2.2\]](#) extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.
- (b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.
- (c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property . . . [45 IAC 2.2-5-8](#). (Emphasis added).

Taxpayer also apparently relies on [45 IAC 2.2-5-10](#) which states in part:

(a) In general, all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment used in direct production. It does not apply to materials consumed in production or to materials incorporated into the tangible personal property produced.

Additionally, the exemption provided in this regulation [45 IAC 2.2] extends to industrial processors. An industrial processor, as defined in IC § 6-2.5-4-2, is one who:

- (1) acquires tangible personal property owned by another person;
- (2) provides industrial processing or servicing, including enameling or plating, on the property; and
- (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

(b) The state gross retail tax will not apply to sales of manufacturing machinery, tools, and equipment which are to be directly used by the purchaser in processing or refining tangible personal property.

(c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.

(Emphasis added).

The statutory authority for the above-cited regulations is found at IC § 6-2.5-5-3 which states in part:

[T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

IC § 6-2.5-5-3(b).

(Emphasis added).

As a threshold issue – as with all the items and transactions addressed within this Letter of Findings – it is the Taxpayer's responsibility to establish that the existing tax assessment is "wrong." As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

In order for Taxpayer's purchase of wrapping and packaging equipment to qualify for the exemption, both the regulation and the statute require that the equipment at issue be "directly used" in "direct production." That means that the equipment or device must have an "immediate effect" on the manufactured items being produced by Taxpayer.

In Taxpayer's case, Taxpayer has failed to produce evidence establishing that the wrapping and packaging equipment is "directly used" in the "direct production" of the production of the products it sends to its various customers. To the contrary, the information provided by Taxpayer indicates the production of the items which Taxpayer delivers occurs elsewhere.

Bearing in mind that it is the Taxpayer's responsibility to establish that the assessment was "wrong" and that exemptions are "strictly construed against the taxpayer," the Department is unable to agree that the wrapping and packaging equipment are exempt from Indiana's sales and use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail Tax – Statute of Limitations.

DISCUSSION

Taxpayer purchased two "classifiers" from Vendor. The transaction was with Vendor on September 19, 2008. Taxpayer argues that assessment of tax on the two purchases is barred by the three-year statute of limitations.

IC § 6-8.1-5-2(a) provides as follows:

(a) Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or either of the following:

- (1) The due date of the return.
- (2) In the case of a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the

motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax, the end of the calendar year which contains the taxable period for which the return is filed.

IC § 6-2.5-3-2 provides that, "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction."

As noted in IC § 6-2.5-3-4(b), "If a person issues a state gross retail or use tax exemption certificate for the acquisition of tangible personal property and subsequently uses, stores, or consumes that property for a nonexempt purpose, then the person shall pay the use tax." (Emphasis added).

It is clear from the information provided by Taxpayer that the retail transaction occurred on September 19, 2008. However, there is nothing to indicate when the two "classifiers" were first used in a taxable fashion such that the items became subject to use tax under IC § 6-2.5-3-2. If the two classifiers were simply placed into inventory or storage at the time they were acquired in September 2008, there would be no taxable incidence until the time the two items were removed from inventory and placed into use.

Without additional information, it is not possible to sustain Taxpayer's argument.

FINDING

Taxpayer's is respectfully denied.

III. Gross Retail Tax – Capital Asset Purchases / Sampling Methodology.

DISCUSSION

Taxpayer maintains that the Department's audit made errors in determining the amount of tax due.

As noted in Part I above, pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-1-2; IC § 6-2.5-4-1. A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2. As in Part I above, IC § 6-8.1-5-1(c), places on Taxpayer the burden of establishing that the original assessment was incorrect.

A. Capital Asset Purchases:

Taxpayer maintains that audit included in its report a transaction with Flex-Pac twice. Taxpayer is correct. The transaction is included on page eight of the audit report once under "Flex-Pac" as the vendor and once again listed as "unknown vendor." The error should be corrected.

Taxpayer made purchases from WW Grainger and submitted invoices establishing that tax was paid at the time of the original transaction. To the extent that the Grainger invoices verify that tax was paid at the time of the original transactions, Taxpayer's protest is sustained.

B. Statistical Sample:

In reviewing Taxpayer's potential use tax liability, the Department employed a statistical sample. As explained in the audit report, at the time the statistical sample was conducted, "The [T]axpayer could not (did not) provide invoices or copies of invoices; therefore, the auditor was unable to complete an accurate review for compliance for state purposes."

In its protest, Taxpayer states the audit's sampling was "inconsistent and unfair" and took "exception to the Department's assessment of tax on credit cards and electronic data interchanges in which tax was paid directly to the vendor."

It should be noted that the audit acted entirely within its authority to conduct a "statistical sampling" of Taxpayer's transactions and to propose an assessment based on that sampling. The authority to do so is found at IC § 6-8.1-3-12(b) which states:

The department may audit any returns with respect to the listed taxes using statistical sampling. If the taxpayer and the department agree to a sampling method to be used, the sampling method is binding on the taxpayer and the department in determining the total amount of additional tax due or amounts to be refunded.

At the outset, it should be noted that Taxpayer has provided nothing which supports its claim that the sampling methodology was in any way "skewed," "inconsistent," or "unfair." To the contrary, the methodology described in the audit report appears entirely even-handed. Nonetheless, Taxpayer has provided copies of invoices which correspond to items contained within the sample. Those invoices indicate that sales tax was paid at the time of the original transactions.

The Audit Division is requested to review the newly submitted invoices and to make whatever adjustments to the original assessment as may be warranted.

FINDING

To the extent that the invoices justify an adjustment to the original assessment, Taxpayer's protest is sustained.

SUMMARY

Taxpayer's purchase of the wrapping and packaging equipment is not exempt from sales or use tax; the assessment of tax on Taxpayer's purchase of two "classifiers" is not barred by the three-year statute of limitations; Taxpayer's argument that audit's sampling methodology was "inconsistent," "unfair" or "skewed" is entirely meritless; the Audit Division will review the newly submitted invoices and make whatever adjustments are warranted.

Posted: 05/28/2014 by Legislative Services Agency
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